

2011

IRS Nationwide
TaxFORUM



Small Business Health Care Tax Credit

2011

IRS Nationwide
TaxFORUM

Small Business Health Tax Credit

Began in 2010

Helps small businesses and tax-exempt organizations afford the cost of covering their employees

Specifically targeted towards employers with low and moderate-income workers



2011

TaxFORUM
IRS Nationwide

Overview

Phases out as firm size and average annual wages increase

Full credit amount for full-time employers with ten or fewer employees and average annual wages of less than \$25,000

Not payable in advance

Credit available in two phases



2011

IRS Nationwide
TaxFORUM

Eligibility

- Fewer than 25 full-time equivalent employees (FTEs) for the taxable year;
- Average annual wages of employees for the year must be less than \$50,000 per FTE; and
- Employer must maintain a “qualifying arrangement.”



2011

IRS Nationwide
TaxFORUM

Eligibility

Steps to determine whether an employer is eligible for a small business health care credit:

1. Determine the employees who are taken into account for purposes of the credit.
2. Determine the number of hours of service performed by those employees.
3. Calculate the number of the employer's FTEs.
4. Determine the average annual wages paid per FTE.
5. Determine the premiums paid by the employer that are taken into account for purposes of the credit.



2011

IRS Nationwide
TaxFORUM

Who is an Employee

Employees who perform services for the employer during the taxable year are generally taken into account

Exclusions from the definition of an employee

If you're not an employees, then your wages, hours and premiums do not count

Seasonal workers are disregarded



2011

TaxFORUM
IRS Nationwide

Counting Hours

Hours of service for a year include:

- Hours worked; and
- Time off

In calculating the total number of hours of service, the employer may use any of the following methods:

- (1) Actual hours of service;
- (2) Days-worked equivalency; or
- (3) Weeks-worked equivalency



2011

IRS Nationwide
TaxFORUM

Counting Hours

Example 1 – For the 2010 taxable year, an employer's payroll records indicate that Employee A worked 2,000 hours and was paid for an additional 80 hours on account of vacation, holiday and illness. The employer counts hours actually worked.

- Under this method of counting hours, Employee A must be credited with 2,080 hours of service (2,000 hours worked and 80 hours for which payment was made or due).

Example 2 – For the 2010 taxable year, Employee B worked 49 weeks, took two weeks of vacation with pay, and took one week of leave without pay. The employer uses the weeks-worked equivalency.

- Under this method of counting hours, Employee B must be credited with 2,040 hours of service (51 weeks multiplied by 40 hours per week).



2011

IRS Nationwide
TaxFORUM

Who is an FTE

$$\text{FTE} = \text{Total hours of service} / 2,080$$

Never credit an employee with more than 2,080 hours of work per year

Round down to next lowest whole number



2011

IRS Nationwide
TaxFORUM

Who is an FTE

Example 1 – For the 2010 taxable year, an employer pays five employees wages for 2,080 hours each, three employees wages for 1,040 hours each, and one employee wages for 2,300 hours. The employer does not use an equivalency method to determine hours of service for any of these employees.

- The employer's FTEs would be calculated as follows:
 1. Total hours of service not exceeding 2,080 per employee is the sum of:
 - a. 10,400 hours of service for the five employees paid for 2,080 hours each ($5 \times 2,080$)
 - b. 3,120 hours of service for the three employees paid for 1,040 hours each ($3 \times 1,040$), and
 - c. 2,080 hours of service for the one employee paid for 2,300 hours (lesser of 2,300 and 2,080).
 - d. The sum of a, b and c equals 15,600 hours of service.
 2. FTEs equal 7 ($15,600 \text{ divided by } 2,080 = 7.5$, rounded to the next lowest whole number).



2011

IRS Nationwide
TaxFORUM

Who is an FTE

Example 2 – For the 2010 taxable year, an employer has 26 FTEs with average annual wages of \$23,000 per FTE. Only 20 of the employer's employees are enrolled in the employer's health insurance plan.

- The hours of service and wages of all employees are taken into consideration in determining whether the employer is an eligible small employer for purposes of the credit. Because the employer does not have fewer than 25 FTEs for the taxable year, the employer is not an eligible small employer for purposes of the credit.



2011

IRS Nationwide
TaxFORUM

Counting Wages

Average annual wages = Total wages/
FTE

Round down to the nearest \$1,000

Only wages paid for hours of service are
taken into account



2011

IRS Nationwide
TaxFORUM

Counting Wages

Example 1 – For the 2010 taxable year, an employer pays \$224,000 in wages and has 10 FTEs.

- The employer's average annual wages is: \$22,000 ($\$224,000 \div 10 = \$22,400$, rounded down to the nearest \$1,000).



2011

IRS Nationwide
TaxFORUM

Calculating Premiums

Only premiums paid by the employer for health insurance coverage are counted

Premiums paid under a cafeteria plan are not employer payments

Employer payments do not count unless made under a qualifying arrangement



2011

IRS Nationwide
TAXFORUM

Calculating Premiums

Example 1 – For the 2010 taxable year, an eligible small employer offers a health insurance plan with single and family coverage. Employer has nine FTEs with average annual wages of \$23,000 per FTE. Four employees are enrolled in single coverage and five are enrolled in family coverage. The employer pays 50 percent of the premiums for all employees enrolled in single coverage and 50 percent of the premiums for all employees enrolled in family coverage (and the employee is responsible for the remainder in each case). The premiums are \$4,000 a year for single coverage and \$10,000 a year for family coverage. The average premium for the small group market in employer's state is \$5,000 for single coverage and \$12,000 for family coverage.

- The employer's premium payments for each FTE (\$2,000 for single coverage and \$5,000 for family coverage) do not exceed 50 percent of the average premium for the small group market in employer's state (\$2,500 for single coverage and \$6,000 for family coverage). Thus, the amount of premiums paid by the employer for purposes of computing the credit equals \$33,000 ((4 x \$2,000) plus (5 x \$5,000)).

2011

IRS Nationwide
TaxFORUM

Calculating Premiums

Example 2 – Using the same facts as in Example 1, except that the premiums are \$6,000 for single coverage and \$14,000 for family coverage.

- The employer's premium payments for each employee (\$3,000 for single coverage and \$7,000 for family coverage) exceed 50 percent of the average premium for the small group market in the employer's state (\$2,500 for single coverage and \$6,000 for family coverage). Thus, the amount of premiums paid by the employer for purposes of computing the credit equals \$40,000 ((4 x \$2,500) plus (5 x \$6,000)).

Example 3 – For the 2010 taxable year, an eligible small employer offers a major medical plan and a dental plan. The employer pays 50 percent of the premium cost for single coverage for all employees enrolled in the major medical plan and 50 percent of the premium cost for single coverage for all employees enrolled in the dental plan.

- The employer can take into consideration the premiums paid by the employer for both the major medical plan and the dental plan, but only up to 50 percent of the amount of the average premium for single coverage for the small group market in the employer's state.

2011

IRS Nationwide
TaxFORUM

Calculating Premiums

Example 4 – Same facts as in Example 3, except that the employer pays 40 percent of the premium cost for single coverage for all employees enrolled in the dental plan.

- The employer can take into consideration only the premiums paid by the employer for the major medical plan, and only up to 50 percent of the amount of the average premium for single coverage for the small group market in the employer's state. The employer cannot take into consideration premiums paid for the dental plan.



2011

IRS Nationwide
TaxFORUM

Transition Relief

Make it easier for small businesses to meet requirements for a qualifying arrangement

Transition relief is available if employer pays at least 50 percent of premium for single coverage for all employees enrolled in employer-provided coverage



2011

IRS Nationwide
TAX FORUM

Transition Relief

Example 1 – Transition relief rule for a qualifying arrangement

- For the 2010 taxable year, an eligible small employer has nine FTEs with average annual wages of \$23,000 per FTE. Six employees are enrolled in single coverage and three employees are enrolled in family coverage.
- The premiums are \$8,000 for single coverage for the year and \$14,000 for family coverage for the year (which do not exceed the average premiums for the small group market in the employer's State). The employer pays 50 percent of the premium for single coverage for each employee enrolled in single or family coverage ($50\% \times \$8,000 = \$4,000$ for each employee).
- Thus, the employer pays \$4,000 of the premium for each of the six employees enrolled in single coverage and \$4,000 of the premium for each of the three employees enrolled in family coverage.
- The employer is deemed to satisfy the uniformity requirement for a qualifying arrangement under the transition relief rule.

Example 2 – Arrangement that does not satisfy requirement for transition relief.

- Same facts as Example 1, except that the employer pays 50 percent of the premium for employees enrolled in single coverage (\$4,000 for each of those 6 employees) but pays none of the premium for employees enrolled in family coverage.
- The employer does not satisfy the uniformity requirement for a qualifying arrangement

2011

IRS Nationwide
TaxFORUM

State Credits and Subsidies

Count credits and subsidies when
determining if there is a “qualifying
arrangement”

Do not count credits and subsidies when
calculating amount of premiums paid



2011

IRS Nationwide
TaxFORUM

Credit Amount

Maximum Credit Amount

- 35 percent for eligible small employers
- 25 percent for eligible tax-exempt small employers



2011

IRS Nationwide
TaxFORUM

Credit Phase Out

The credit phases out gradually (but not below zero) for eligible small employers if the number of FTEs exceeds ten or if the average annual wages exceed \$25,000.

If the number of FTEs exceeds ten, the reduction is determined by multiplying the otherwise applicable credit amount by a fraction, the numerator of which is the number of FTEs in excess of ten and the denominator of which is 15.

If average annual wages exceed \$25,000, the reduction is determined by multiplying the otherwise applicable credit amount by a fraction, the numerator of which is the amount by which average annual wages exceed \$25,000 and the denominator of which is \$25,000. In both cases, the result of the calculation is subtracted from the otherwise applicable credit to determine the credit to which the employer is entitled.

For an employer with both more than ten FTEs and average annual wages exceeding \$25,000, the total reduction is the sum of the two reductions.



2011

TaxFORUM
IRS Nationwide

Calculating the Credit

How to calculate the credit:

1. Calculate maximum amount of the credit;
2. Reduce maximum credit in step 1 according to phase out rule (if necessary); and
3. Determine the employer's actual premium payment (if receiving a state credit or subsidy).



2011

IRS Nationwide
TAXFORUM

Calculating the Credit

Example 1 – Calculating the maximum credit for a taxable eligible small employer.

- For the 2010 taxable year, a taxable eligible small employer has 9 FTEs with average annual wages of \$23,000 per FTE. The employer pays \$72,000 in health insurance premiums for those employees (which does not exceed the average premium for the small group market in the employer's state) and otherwise meets the requirements for the credit.
- The credit for 2010 equals \$25,200 ($35\% \times \$72,000$).

Example 2 – Calculating the maximum credit for a tax-exempt eligible small employer.

- For the 2010 taxable year, a tax-exempt eligible small employer has ten FTEs with average annual wages of \$21,000 per FTE. The employer pays \$80,000 in health insurance premiums for its employees (which does not exceed the average premium for the small group market in the employer's state) and otherwise meets the requirements for the credit. The total amount of the employer's income tax and Medicare tax withholding plus the employer's share of the Medicare tax equals \$30,000 in 2010. The credit is calculated as follows:
 - Initial amount of credit determined before any reduction: ($25\% \times \$80,000$) = \$20,000
 - Employer's withholding and Medicare taxes: \$30,000
 - Total 2010 tax credit equals \$20,000 (the lesser of \$20,000 and \$30,000).

2011

IRS Nationwide
TaxFORUM

Calculating the Credit

Example 3 – Calculating the credit phase-out if the number of FTEs exceeds ten or average annual wages exceed \$25,000.

- For the 2010 taxable year, a taxable eligible small employer has 12 FTEs and average annual wages of \$30,000. The employer pays \$96,000 in health insurance premiums for its employees (which does not exceed the average premium for the small group market in the employer's state) and otherwise meets the requirements for the credit.
- The credit is calculated as follows:
 1. Initial amount of credit determined before any reduction: $(35\% \times \$96,000) = \$33,600$
 2. Credit reduction for FTEs in excess of 10: $(\$33,600 \times 2/15) = \$4,480$
 3. Credit reduction for average annual wages in excess of \$25,000: $(\$33,600 \times \$5,000 / \$25,000) = \$6,720$
 4. Total credit reduction: $(\$4,480 + \$6,720) = \$11,200$

Total 2010 tax credit equals \$22,400 $(\$33,600 - \$11,200)$.



2011

TaxFORUM
IRS Nationwide

Claiming the Credit

Credit is claimed on an eligible small employer's annual income tax return using Form 8941

Credit offsets an employer's actual tax liability for the year

For a tax-exempt, credit is a reduction in payroll taxes

Section 162 deduction is reduced by amount of Section 45R credit

2011

IRS Nationwide
TaxFORUM

Changes in 2014

Maximum amount of the tax credit is
50% (35% for tax-exempt employers)

Credit is only available to small
businesses purchasing health insurance
through an exchange

Credit is only available for two years



2011

IRS Nationwide
TaxFORUM



Contact Information

Bridget Roberts

bridget.roberts@irs.gov

1-877-777-4778

www.irs.gov/advocate